■ ROGER SMITH SPEAKS OUT • THE NEXT RECESSION • GREAT JAPANESE MISTAKES

FEBRUARY 13, 1989

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FORTUNE

SPEED

Beating competitors to market is today's hottest strategy. Here's why— and how to do it.

Hewlett-Packard chief John Young has cut product development times up to 60%.

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FEBRUARY 13, 1989

FORTUNE

"Product development was like elephant intercourse. Much hooting and throwing of dirt, and then nothing would happen for a year." COVER STORY/PAGE 54

COVER: Katherine Lambert photographed Hewlett-Packard Chief Executive John Young at the company's direct marketing distribution center in Sunnyvale, California.

MANAGING/Cover Stories

HOW MANAGERS CAN SUCCEED THROUGH SPEED 54

It takes more than just stepping on the gas. Today's hottest competitive strategy requires companies to transform themselves. The rewards of being quicker to market are worth the effort. *by Brian Dumaine*

HEWLETT-PACKARD'S WHIP-CRACKER 58

He's Chief Executive John Young, who believes speed will be the essential management tool of the Nineties.

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Training employees in several jobs can help companies respond to the market faster. It also increases efficiency, quality, productivity, and job satisfaction. *by Norm Alster*

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ROGER SMITH: "THE U.S. MUST DO AS GM HAS DONE" 70

In a first-person account, GM's chief executive talks frankly about his record at the helm of the world's largest industrial company. Excerpt: "If I had the opportunity to do everything over again, I would make exactly the same decision that I made in 1981 . . . I'd rebuild General Motors, inside out and from the bottom up . . . But I sure wish I'd done a better job at communicating with GM people." He also reflects on criticism, his favorite gadgets, factory automation, and why he has a Xerox machine at home.

THE ECONOMY

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Quite possibly not for a good while, and the next one needn't be severe. New forces, from the growth of services to financial deregulation, are moderating the business cycle and reducing risks. Forecasters expect growth for at least another year, but most still bake a downturn into their long-run cakes. Even this resilient expansion, a Methuselah among upswings, could be laid low by shock or folly. *by Louis S. Richman*

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Watch out, Wall Street—policymakers of every political hue have decided that takeover artists borrow too much. Says a top congressional aide: "Something will be done. The question is what." Eliminating tax deductibility of interest is probably too radical. Expect more modest steps that will remove some thrill and profit—and risk—from the leverage game. *by Ann Reilly Dowd*

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"The drug smugglers are going to be limited only by their imaginations."

PAGE 8

"People look at this as helping the company and say, 'They never helped me. Why should I help them?' "

PAGE 66

"When I saw that our people didn't understand my vision for GM, I knew I had to get them on board. And I did."

PAGE 70

"Look, you're paying more for this company than an American would."

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"We're undergoing a change like Honda did when it went from making motorcycles to cars."

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"What is most dangerous about the new racism on campus is that the responses to it set the stage for more."

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WHAT FOREIGNERS WILL BUY NEXT 94

Auto parts makers, semiconductor producers, and biotech outfits with lots of strong patents will be the hottest tickets. Look for some very fancy prices. But unlike LBO buyers, foreign acquisitors are less interested in big, cash-rich companies loaded with plodding divisions that can be sold to pay off debt, and more interested in strategic goals. Says a senior vice president of a major Japanese trading company: "We don't sell our babies to pay the bills. Breaking up companies is not our way." *by John J. Curran*

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Now it can be told! Readers have discovered that the corporate world is about Money! Power! Sex! Some authors are getting rich quick. Read all about it! *by Christopher Knowlton*

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EDITOR'S DESK

MARIANNE BARCELLONA

Speed merchant Brian Dumaine burns up the ice on New York City's Wollman rink.

PARTICIPATIVE management, just-in-time inventory, quality circles—recent years have brought a panoply of techniques from which managers can choose. What a feast! But, sadly, not wholly satisfying. For none of these has proved the be-all and end-all solution to making a company run faster, jump higher, and clobber the competition.

Speed—the subject of our cover package (page 54)—is a new technique that proponents claim does just that. More formally called time-based strategy, it is founded on a simple precept: Think in terms of time—how long it takes to develop, manufacture, and deliver a product or service. Devotees of speed get orders out faster and products to market sooner. And that, after all, is what competition is all about.

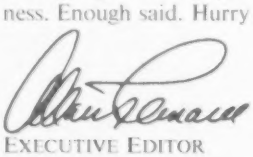
Our man on the speed beat is associate editor Brian Dumaine, who has been fast on his feet since his teenage days playing hockey on the ponds of New Hampshire. Dumaine, who was assisted by reporter Sarah Smith, knew he was onto a good story when a consultant told him about a client corporation that was using speed techniques. Alas, Dumaine says, the company's executives would not talk: "They thought they had found such a valuable management tool they didn't want the competition to know about it." Fortunately, other companies—Motorola, AT&T, and GE among them—felt less constrained. John Young, CEO of Hewlett-Packard and an avowed disciple of speed, allowed as how he has adopted some personal time-management techniques, including one you will read about called just-in-time worrying.

STEVEN W. LAPP

Norm Alster

Norm Alster's accompanying article describes a related development, training workers in several different skills. By building flexible work forces, companies not only increase speed; they also enhance quality, efficiency, and job satisfaction. Says Alster: "Having workers who can do more than one job addresses many different kinds of strategic challenges—the need to improve productivity, respond to changing technology, and maintain competitiveness despite growing shortages of skilled labor."

Strategy. Challenge. Competitiveness. Enough said. Hurry up and read.



EXECUTIVE EDITOR

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BY JOHN J. CURRAN

STOP WORRYING ABOUT THE ECONOMY AND CONCENTRATE ON FINDING VALUE

Some "recession-proof" stocks are overpriced, says FORTUNE's quarterly investment guide.

■ What's a poor fellow to believe? The seers at Drexel Burnham Lambert think the economy will flourish in 1989, corporate earnings will grow 8%, and stocks will climb. Strategists at Donaldson Lufkin & Jenrette expect the economy to wither, earnings growth to sputter, and stocks to slip.

Life need not be so difficult in these uncertain times. Investment strategy does not rely on forecasting, or at least it shouldn't. Rather, it should be a thoughtful balancing of risks and returns. The risks at this juncture are real enough—higher interest rates, recession, a falling stock market—but they are not so great that investors should pass up potential winnings. The stock market is not dangerously overvalued, and good investments can be found. Despite rising interest rates, some bonds are worth considering. Promising niches can be found, too, in real estate and commodities.

The smartest course now is to allocate your funds as though you might have to ride those investments through a recession. That's not a forecast, but a recommended exercise that will make you focus on the underlying value of securities. Happily, these very same investments are also the best performers in good times. What follows is a guide to the principal markets.

■ **STOCKS:** For the past six years, even with Black Monday figured in, the stock market has averaged a 16.5% compound annual return. Don't plan your retirement around that number. Though stocks are still a good investment, the return in coming years should more closely approximate the long-term historical average of 10% per year—roughly half from appreciation and half from dividends. That's a long way from what investors have grown accustomed to, but it beats money market funds.

But what about rising interest rates, which are supposed to be bad for stocks? At their current levels, interest rates are not the threat that many people believe. One time-tested measure compares the interest rate on Treasury bills with cash-flow yields—the percentage return investors would get if all the cash flow on stocks were paid out as dividends. Cash flow is considered a more accurate gauge of stocks' attractiveness than dividends because it includes money that companies can use for stock repurchases. When cash-flow yields fall to less than twice the T-bill rate, it is time to sell stocks. Such a one-shot measure of stocks' worth may seem a bit simplistic. But it tipped investors off to the 1983 market decline of 15%, as well as the 1987 debacle.

Currently the indicator is mildly bullish:

WHAT THE HECK DO I DO NOW?

FOUR BY FIVE

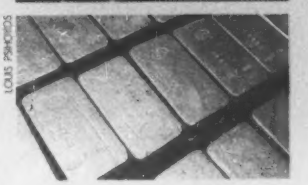
STOCKS
■ **The safest bets are big growth stocks, entertainment companies, and—no fooling—basic industry.**

IMAGE BANK

BONDS
■ **T-bills and long-term Treasuries are buys, but the gray panthers have driven municipals out of sight.**

FOUR BY FIVE

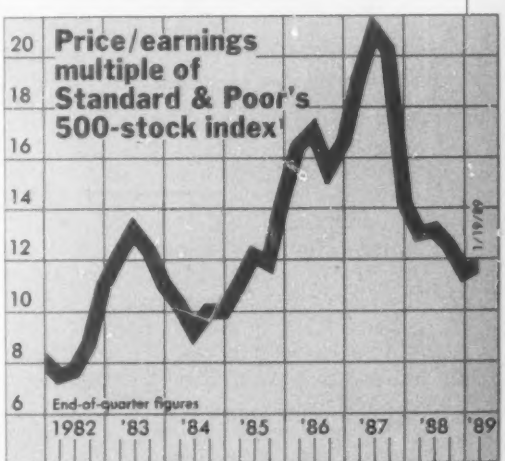
REAL ESTATE
■ **Offices and shopping malls are hurting. Warehouses and Texas properties are worth a look.**


LOUIS PSHOYOS

COMMODITIES
■ **Gold, corn, and soybeans could decline. But a Midwestern drought is driving up the price of winter wheat.**

OVERPRICED NO MORE

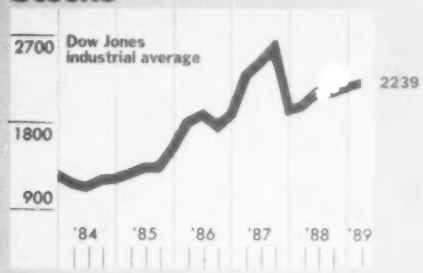
Corporate earnings zoomed far more than stock prices in 1988, and the market's P/E dropped to 12.2, a level not seen since 1985.



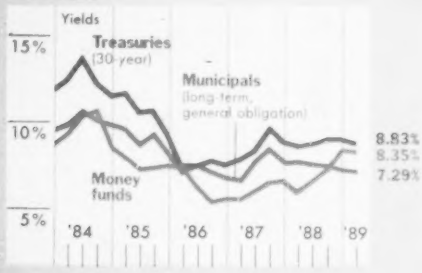
[1]BASED ON EARNINGS FOR THE LATEST FOUR QUARTERS.

STATE OF THE MARKETS

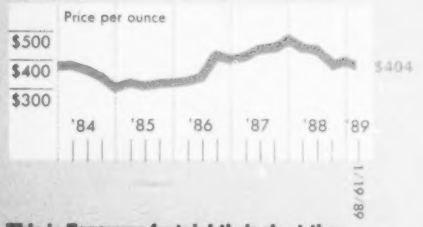
Stocks



Bonds



Gold



This is FORTUNE's fortnightly look at the major markets of the past five years.

*BASED ON EARNINGS FOR THE LATEST FOUR QUARTERS.

SOURCES: SALOMON BROTHERS, BOND BUYER, DONOGHUE'S MONEY FUND REPORT, COMMODITY EXCHANGE

The cash-flow yield on stocks is still 2.3 times the T-bill rate. Says Elaine Garzarelli, the chief quantitative analyst at Shearson Lehman Hutton and a true believer in this number: "It won't yield a sell signal unless the rate on T-bills rises from the current 8.2% to 9.5%, or unless stocks rise above 320 on the S&P 500, which would lower the cash-flow yield." The S&P 500 recently was 11% below Garzarelli's sell point.

Investors' other great fear is recession. The risk that the recent run-up in short-term interest rates could nudge an already mature recovery over the edge is real enough. But investors who dive in and out of stocks on the basis of business-cycle worries may leave the market at the wrong time. Even if the economy does turn down, who's to say you will get back into the market at the right time? Many of the market's most dramatic gains have come during recessions.

A smarter bet is to allocate the stock portion of your portfolio to issues that will hold up well in recession. Oddly, the old-time favorites like utility stocks no longer fit the bill. Many of them have been bid so high over the past year in anticipation of recession that some analysts consider them overvalued. Food stocks, another recession refuge in years past, have been pushed up in the frenzy of corporate takeovers.

Among the most solid bargains right now, says investment strategist Steven Einhorn of Goldman Sachs, who is generally wary of stocks, are the large-capitalization growth stocks. **Sallie Mae**, the student loan marketing organization, and **Philip Morris**, he says, "offer solid growth and they are very attractively priced." Einhorn also likes **Merck** and some other big drug companies.

Mario Gabelli, chairman of Gamco Investors, one of the most successful investment firms on Wall Street, believes stocks like those of moviemaker **MCA** are the best way to prepare a portfolio for a recession without forfeiting returns. "A movie's sales are a function of its appeal, not of the economy," he says. More important, the stock, recently going at $47, has a potential breakup value in the mid-$60s. **Warner Communications** is another sure-footed entertainment company with takeover possibilities, says Gabelli, who puts the takeover value at roughly 50% above Warner's current price.

It's usually thought that cyclical industries like aluminum and paper are the last place to be in a recession. But after repeated cost cutting, many companies in basic industries are primed to keep pumping profits even if the economy sputters. Michael Sherman, investment strategist at Shearson Lehman Hutton, is advising clients to load up on **Alcan Aluminium**, **Dow Chemical**, and **Stone Container**.

■ **BONDS:** Rising interest rates are bullish for bonds. That's right. Though they mean lower bond prices for now, they also suggest a slower economy down the road. That should pave the way for yields to sink and for prices to ascend.

It takes willpower to buy bonds when rates are rising, but it should soon prove to have been a smart move. Inflation at 4% is simply not high enough to support a sustained uptrend in bond rates. Even if inflation creeps up to 5%, as FORTUNE expects, the inflation-adjusted yield will still be generous by historical standards.

The more vexing question is which bonds to be in. Both intermediate ten-year Treasury bonds and long-term 30-year bonds yield roughly 9% these days. Many investors balk at buying the riskier long-term bonds because the coupon rate is no greater than for short-term bonds whose prices are less prone to fluctuation. But Larry Biehl, a San Francisco financial adviser who is telling his clients to buy long bonds, expects the rate on T-bonds to be down to 8% by the end of 1989. If so, their prices would rise handsomely. By one rule of thumb, a 30-year bond rises 10% for every percentage point drop in interest rates, whereas a ten-year bond rises only 6%. Says Biehl: "We're playing bonds for the total return, not just the coupon."

For investors with a lower tolerance for risk, money market yields are temptingly plump these days: 8.4% in mid-January, up from 7.5% just three months earlier. The biggest drawback to short-term yields is that they are short term. Interest rates may be high today, but they could start falling next week.

Certificates of deposit and Treasury bills, available in maturities of three months and up, allow you to lock up today's rates for a while. But it pays to shop around. One pleasant surprise: Three-month Treasury bills now pay *more* than bank CDs of the same maturity, and the income is exempt from state and local taxes. How can this be? Says Norberto Mehl of Banxquote, a money market data service: "Banks have felt that they could afford to offer rates that lag behind Treasuries because the demand for CDs has been so strong." Mehl believes this quirky situation, in which investors can enjoy the extra security of a Treasury plus a higher yield, won't last long.

The municipal market is full of expen-

REPORTER ASSOCIATES *Joshua Mendes and Ellen Schultz*

sive merchandise. One reason is that the elderly are scrambling to lower their taxable income and minimize the effects of the new Medicare Catastrophic Coverage Act, which slaps a surtax on most oldsters.

As a result of the heightened demand, muni yields are hardly a prize these days. For an investor in the 28% tax bracket, the 6.6% yield on a five-year AA-rated bond is no greater than the after-tax yield on a five-year Treasury. Investors in the 33% bracket, however, can still come out slightly ahead with munis.

Convertibles are looking more attractive. Their yields are fat compared with those on stocks—7.5% on average, vs. 3.6% on the S&P 500. Furthermore, analysts at First Boston note that the conversion premium on converts—or the amount by which their price exceeds the value of the stock for which they can be exchanged—is about 22%, down from 34% a year ago. Unlike straight corporate bonds, converts can benefit from takeovers, which drive up the price of the underlying stock, though they can be hurt as well. Because it's difficult to buy and sell small quantities of corporate bonds, individual investors are better off playing these securities through a convertible mutual fund. Two with good records are **American Capital Harbor** and **Dreyfus Convertible Securities**.

■ **REAL ESTATE:** Returns from brick-and-mortar investments have been crumbling amid oversupply and slumping demand. The chart at right shows that the vacancy rate in offices, though down from the 1986 peak, is still generally high. Other soft spots abound. Housing prices in the Northeast are slipping, public storage warehouses are in oversupply, and many shopping malls are falling on hard times.

Still, these gloomy developments have a bright side. Falling prices ultimately yield bargains. One of the most promising places to invest nowadays is Texas, where real estate prices have been dropping for four straight years. Houston and its suburbs, with a horrific 28.7% office vacancy rate, have enough empty space for 78 skyscrapers. But real estate experts say the city's prospects are beginning to improve. Unemployment in the Lone Star state is down to 7.1% from a high of 11.1% in 1986. Investors who venture in, however, should do so only with experienced guides.

One of the best routes to Texas real estate is through **Weingarten Realty Investments**, a REIT that has been investing in Texas real estate since 1948. Weingarten owns 106 shopping centers and has managed to keep them 94% leased even through the worst of times. The stock currently trades at $27 a share, and Burland East, a real estate analyst at Alex. Brown in Baltimore, thinks it will hit $40 when the Texas economy picks up. Investors won't go hungry in the meantime: The dividend yield is a beefy 6.2%.

Industrial warehouses are another promising area. In many cities, demand for space is strong thanks to the lower dollar, which has boosted exports. Investors have very few ways to play this highly specialized market. One REIT heavily invested in industrial warehouses is **Copley Properties** in Boston. Copley is slightly more risky than most other REITs because it builds new warehouses instead of just buying and leasing. But investors are compensated for that risk with a yield of 9.8%.

■ **COMMODITIES:** Despite recent upticks in some commodity prices, worldwide inflation is still subdued. That's bad news for goldbugs, and here's some more. A recent study by Morgan Stanley notes that gold is selling well above the cost of digging up more of the stuff. Based on current mining costs, the replacement value of gold is about $300 per ounce, far less than the $404 per ounce gold fetches on the market. Nevertheless, investors who have been itching to buy a bit of gold for peace of mind might take advantage of its recent weakness. Because gold pays no dividend and offers little prospect of price appreciation, invest no more than 5% of your portfolio.

As the FBI's sting in the Chicago exchanges shows, trading in commodity futures can be dangerous to your wallet. But the game, whose market risks dwarf any fraud revealed so far, goes right on. Things were looking splendid for corn and soybean speculators just a few weeks back, when concerns about dwindling supplies were driving up futures prices. But those prices were mowed down by experts from the U.S. Department of Agriculture, who in January raised their estimate of the 1988 crop. Alan London, a futures analyst at Paine Webber in Chicago, thinks the versatile bean could fall to $7 per bushel from the current price of $7.60. Corn could go to $2.25 from its current price of $2.70. If he is right, this spring will produce a bountiful harvest for short-sellers.

The most promising prospect down on the farm is hard winter wheat, primarily used for baking bread. Two of the main growers—China and the U.S.—are suffering dry spells in their chief wheat-growing regions. Two drought years back-to-back haven't hit the U.S. since the dust bowl of the 1930s. Richard Loewy, a grain analyst at Prudential-Bache, thinks the supply problem could become acute. "We could be going into March in a desperate situation," he says. Unless rain starts falling soon in the Midwest, Loewy thinks, wheat could reach $5.50 on the September futures contract. To those willing to make a bet at current prices, Loewy's prediction suggests a potential profit of $7,000 per contract, or a 412% return on a $1,700 down payment. The only drawback is in what your neighbors might think when they see you cheering on the drought.

OFFICE VACANCY RATES

CITY	1983	1986	1988
Atlanta	10.3%	18.3%	17.1%
Boston	7.7%	13.8%	13.7%
Chicago	12.8%	17.3%	13.5%
Dallas	23.2%	27.7%	28.0%
Denver	26.4%	26.5%	25.1%
Houston	29.1%	29.9%	28.7%
Los Angeles	15.9%	17.3%	15.4%
Miami	11.4%	21.1%	24.3%
San Francisco	10.6%	19.4%	15.3%
Washington, D.C.	10.1%	14.8%	12.8%
National Average	16.2%	21.5%	19.7%

SOURCE: COLDWELL BANKER OFFICE VACANCY INDEX

The office glut is starting to ease in most metropolitan areas, but only steely nerved contrarians should invest.

HOW MANAGERS CAN SUCCEED THROUGH SPEED

"If you knew Time as well as I do," said the Mad Hatter, "you wouldn't talk about wasting it." —Alice in Wonderland

THE NUMBERS are nearly incredible. General Electric used to take three weeks after an order to deliver a custom-made industrial circuit breaker box. Now it takes three days. AT&T used to need two years to design a new phone. Now it can do the job in one. Motorola used to turn out electronic pagers three weeks after the factory got the order. Now it takes *two hours*.

Speed is catching on fast. A recent survey of 50 major U.S. companies by Kaiser Associates, a Vienna, Virginia, consulting firm, found that practically all put time-based strategy, as the new approach is called, at the top of their priority lists. Why? Because speed kills the competition.

Quickly developing, making, and distributing products or services brings important, sometimes surprising competitive benefits. Market share grows because customers love getting their orders *now*. Inventories of finished goods shrink because they aren't necessary to ensure quick delivery; the fastest manufacturers can make and ship an order the day it's received. For this and other reasons, costs fall. Many employees become more satisfied because they're working for a more responsive, more successful company and because speeding operations requires giving them more flexibility and responsibility (though the changes can be controversial—see following story).

Even quality improves. Explains Hewlett-Packard Chief Executive John Young, a leading apostle of speed: "Doing it fast forces you to do it right the first time." By placing speed at the heart of his strategy, Young has enabled his company to turn out computer terminals at lower cost than those master clonemakers, the Taiwanese. In FORTUNE's seventh annual survey of corporate reputations, published in the last issue, computer executives and security analysts ranked Hewlett-Packard the most admired company in its industry—displacing perennial champ IBM.

Speed often pays off in product development even if it means going over budget. An economic model developed by the McKinsey & Co. management consulting firm shows that high-tech products that come to market six months late but on budget will earn 33% less profit over five years. In contrast, coming out on time and 50% over budget cuts profits only 4%.

Little wonder that corporate speed is becoming a principal topic of study among management consultants and business school professors. It has the conceptual heft to influence virtually every operation in every company. What manager doesn't feel overwhelmed by the confusing catalogue of "hot" management methods? What's the magic recipe? Is it just-in-time inventory blended with quality circles or, uh, the flat organization and a pinch of pay for knowledge? All are valuable tools, but none by itself is the answer.

It takes more than just stepping on the gas. Companies must transform themselves—and the rewards are worth it.

■ *by Brian Dumaine*

"Thinking in terms of time," says Rudyard Istvan, a senior vice president at Boston Consulting Group, "gets all those activities working together for a common purpose." For example, Young declared early last year that Hewlett-Packard's breakeven time, or the interval between a new product's conception and profitability, including covering all development costs, must be cut in half across the entire corporation (see box). That can be done in many ways, but faster product development is one of the best. Faced with such a simple yet staggering goal, employees are forced to begin pulling in the same direction and deciding which management tools—just-in-time inventory, quality circles, new worker incentives—would best help meet it.

Honda uses its Formula One race cars to keep speed in the corporate consciousness and teach engineers lessons for the factory.

A company can generally find thousands of ways to speed operations, but masters of the game emphasize a few major tactics. Among them:

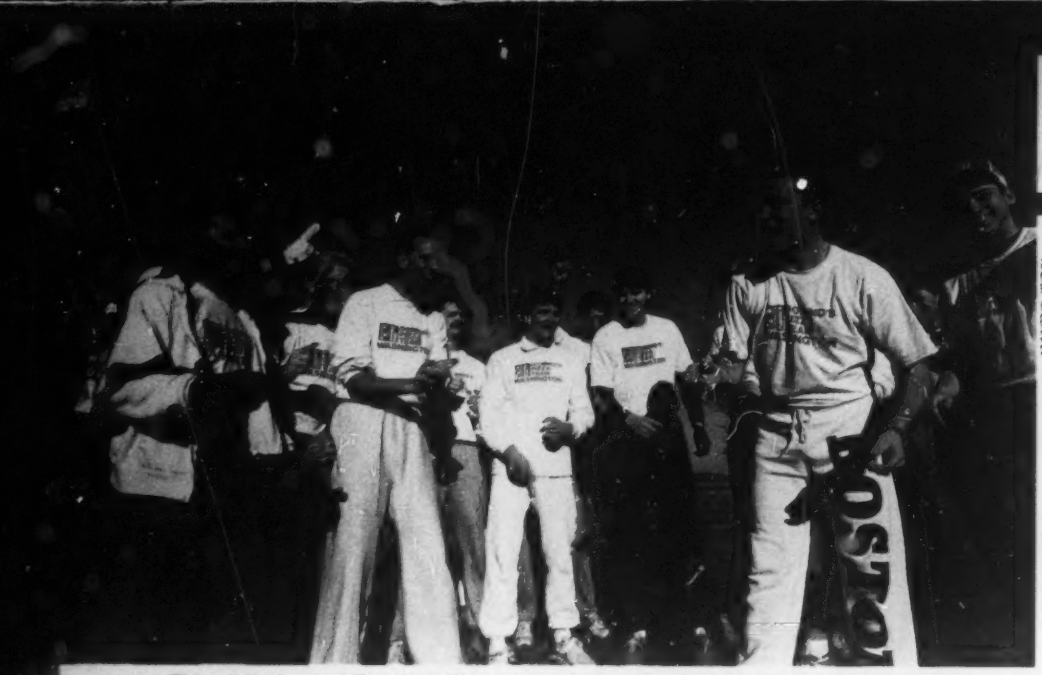
■ **START FROM SCRATCH.** Practically everyone agrees that the worst way to speed up a company is by trying to make it do things just as it does, only faster. The machinery—and certainly the workers—will simply burn out. Instead, smart executives announce a breathtakingly ambitious goal, like Young's target of halving breakeven time. No one can get there just by stepping on the gas, although some try. "The gut reaction," says Steven Wheelwright, a professor at the Harvard business school, "is, let's cut six months out. It's not, let's do the analysis and rethinking that will allow us to cut six months out."

But that's what it takes. Example: General Electric's rescue of its old and stagnant circuit breaker business. Says William Sheeran, a GE general manager: "We had to speed up or die." GE's $1-billion-a-year electrical distribution and control division in Plainville, Connecticut, makes, among other things, circuit breaker boxes for commercial buildings. When threatened in the early 1980s by the market's slow growth and tough competitors like Siemens and Westinghouse, GE assembled a team of manufacturing, design, and marketing experts that focused on overhauling its manufacturing process. The goal, suitably daunting, was to cut the time between a customer's order and delivery from three weeks to three days.

Time for radical thinking. GE was producing circuit breaker boxes in six plants around the U.S. Who needs six? The team decided that one plant would be more efficient, so in 1985 it consolidated its operations and focused on automating its factory in Salisbury, North Carolina.

But the team didn't want to automate operations as they were. In the old system, engineers custom-designed each box, a job that took about a week. They chose from 28,000 unique parts to create the boxes, and setting up an automated system to han-

PHOTOGRAPH BY ERIC VARGIOLU—D.P.P.I



WALTER CALLAHAN

The spirit of speed: Domino's Pizza store managers get psyched up for a six-mile run.

dle that many parts would have been a nightmare. So the design team made most of the parts interchangeable, reducing their number to 1,275 while still leaving customers a choice of 40,000 different sizes, shapes, and configurations of boxes.

The team also devised a way to cut out the engineers, replacing them with a computer. Now when a salesman enters specifications for a circuit breaker into a computer at GE's main office in Connecticut, the order flows to a computer at Salisbury, which automatically programs the factory machines to make circuit breaker boxes with minimum waste of material.

Impressive advances, but the team still had to conquer another source of delay: solving problems and making decisions on the factory floor. The solution was to get rid of all line supervisors and quality inspectors, reducing the organizational layers between worker and plant manager from three to one. Everything those middle managers used to handle—vacation scheduling, quality, work rules—became the responsibility of the 129 workers on the floor, who are divided into teams of 15 to 20. And what do you know: The more responsibility GE gave the workers, the faster problems got solved and decisions made.

Today the Salisbury plant basically runs itself at a rapid clip. On the factory wall a giant electronic sign hung 25 feet off the ground flashes in red letters, letting workers know how long it's taking them to make each circuit breaker box, how many boxes they have to make that day, and how many they've made so far. The sign lets employees pace themselves and make their own scheduling decisions. Says Dottie Barringer, an ebullient woman who has worked at the plant for the past 12½ years: "I like to be my own boss. I don't like to be told what to do. I know if I can't get it done in eight hours, I can do it in ten without getting permission for overtime. We're behind right now. No one has to tell us we have to work Saturday."

Results: The plant, which used to have a two-month backlog of orders, now works with a two-*day* backlog. Productivity has increased 20% over the past year. Manufacturing costs have dropped 30%, or $5.5 million a year, and return on investment is running at over 20%. The speed of delivery has shrunk from three weeks to three days for a higher-quality product with more features. GE is gaining share in a flat market. Says Sheeran: "We'd be out of business if we hadn't done it."

■ **WIPE OUT APPROVALS.** Consultants recommend that managers take a hard look at the number of times a product or service requires some sort of internal approval before reaching the customer. Philip Thomas, president of Thomas Group, a Dallas consulting firm specializing in speed, says that manufacturing typically takes only 5% to 10% of the total time between an order and getting a product to market; the rest is administrative. Says he: "Most people don't know how their own company works. Make a flow chart of your administrative process to show what's really happening out there. It usually shows that getting a product to market takes longer than people think."

Jack Reichert, CEO of Brunswick, the $3-billion-a-year sporting goods company, decided in the mid-Eighties that developing new products—outboard motors, automatic bowling scorecards, fishing reels—took too long. "Product development was like elephant intercourse," he says. "It was accompanied by much hooting, hollering, and throwing of dirt, and then nothing would happen for a year." A top amateur bowler who says he has modeled Brunswick on Japanese companies, Reichert cut the layers of management between him and the

SUPERFAST INNOVATORS

Company	Product	Development time OLD	NEW
Honda	cars	5 years	3 years
AT&T	phones	2 years	1 year
Navistar	trucks	5 years	2.5 years
Hewlett-Packard	computer printers	4.5 years	22 mos.

SUPERFAST PRODUCERS

Company	Product	Order-to-finished-goods time OLD	NEW
GE	circuit breaker boxes	3 weeks	3 days
Motorola	pagers	3 weeks	2 hours
Hewlett-Packard	electronic testing equipment	4 weeks	5 days
Brunswick	fishing reels	3 weeks	1 week

shop worker from ten to five. Says he: "If you want to know how to do a job right, ask the people who are doing it; don't have some corporate bureaucracy tell them how to do it." Reichert also bumped up spending authority for division heads from $25,000 to $250,000. At headquarters in Skokie, Illinois, he gets only a weekly one-page report from each division chief. "Those reports," says Reichert, "tell me what *they* need." Reichert estimates that Brunswick can now develop new outboard motors, for example, 25% to 30% faster.

The same principle works in service companies. At Adca Bank, a subsidiary of West Germany's Rabobank (assets: $90 billion), a loan used to go through numerous layers of bureaucracy. Says Hans Van der Velde, managing director at Adca Bank: "Someone at the branch sent loan papers to someone at headquarters who was looking at them and changing them. Then his boss was looking and changing them. All those layers were useless." The bank got rid of five layers and gave officers in all branches more authority. Before, it took 24 man-hours to approve a loan. Now it takes 12.

■ **TRY TEAMS.** Like GE in its circuit breaker business, nearly all the fastest companies form multidepartment teams. AT&T is applying that approach to product development with resounding success, giving its teams tough deadlines and lots of authority to make the decisions required to meet them. AT&T used to take two years designing a new telephone. But, says John Hanley, an AT&T vice president of product development, "We came to the realization that if you get to market sooner with new technology, you can charge a premium until the others follow."

AT&T began developing a new cordless phone for the home called the 4200 in early 1988. Hanley faced a rigid AT&T bureaucracy and was skeptical about his chances of cutting time out of the development process. Rather than trying to save 10% in time here and 5% there, Hanley aimed to reduce the development cycle by 50%. Says he: "It made us change the way we did everything." In the past, AT&T product development worked like a relay race, with the engineering department handing a design over to manufacturing, which handed the finished product over to marketing to sell. For the 4200, Hanley considered setting up a skunk works, a product development lab off premises where engineers could work relatively free of bureaucracy. He soon rejected that idea, figuring that if his people couldn't develop a new product within AT&T they wouldn't achieve a significant and permanent change.

Instead, Hanley formed teams of six to 12, including engineers, manufacturers, and marketers, with authority to make every decision on how the product would work, look, be made, and cost. The key was to set rigid speed requirements—six weeks, say, for freezing all design specs. Because the team didn't need to send each decision up the line for approval, it could meet these strict deadlines. With this new approach AT&T cut development time for the 4200 phone from two years to just a year while lowering costs and increasing quality.

Some companies make suppliers part of the team. Navistar, the Chicago truckmaker, landed a major contract with U-Haul in 1987 by promising to deliver a new moving van fast. It was a stiff challenge. To make loading easier, the truck bed had to be only 24 inches off the ground, compared with the standard 48 inches. That required an entirely new chassis design and a novel type of pneumatic suspension that lowered the truck bed four inches at the flick of a switch. Says Neil Springer, chief of Navistar's truck building subsidiary: "We realized we couldn't deliver the truck fast enough in the traditional way. It had to be done in teams, with everybody, suppliers included, working simultaneously." The approach succeeded and produced a bonus. Dana, a supplier that makes frames and axles, suggested a way to help lower the bed by redesigning the axle, a suggestion that would not have been heard until perhaps a year later under normal procedures. Taking advantage of it would have caused considerable delay while manufacturing retooled. Instead engineering got Dana's suggestion into the original specs.

CATHERINE LARGE

Brunswick CEO Reichert: making new-product development less like elephant intercourse

■ **WORSHIP THE SCHEDULE.** Managers must make clear that nothing short of disaster is a valid excuse for delay. Last year Motorola designed a new electronic pager and an automated factory to build it in an unheard-of 18 months rather than the standard three years. The first step to achieving that goal was setting clear deadlines. After that came discipline.

continued

CEO Young believes speed will be the essential management tool of the Nineties.

HEWLETT-PACKARD'S WHIP-CRACKER

You wouldn't suspect that John Young lives life in the fast lane. He has worked for one company, Hewlett-Packard, for 31 years. He's been married to one wife—they met in elementary school—for 34 years. He drives himself to the office every morning by 7:30. For relaxation he likes to go fishing.

But when it comes to work, Young, 56, is obsessed with speed. He is not an easy man to read, not demonstrative or introspective. He reminds many of a fighter pilot—cool, competent, confident. He's cheerful and wants to be liked; new parents who work at Hewlett-Packard receive a baby blanket from him, and newlyweds get a silver bowl. But he is obviously driven. He insists that Hewlett-Packard develop, manufacture, and deliver products faster than ever before and faster than the competition. He conveys that message repeatedly, jetting around the world to the company's 55 divisions, and he takes it to heart. A manager at the company says that if she leaves an important query on his desk at 5 P.M., "you can bet a year's salary an answer will be on my desk when I walk in the next morning."

Young's drive to work takes only eight minutes. Once there, he practices what he calls just-in-time worrying: not bothering with a task until he absolutely must. For example, he won't go over a speech until minutes before delivering it. Why? "If you worry too soon," he says, "things will change in the interim, so you end up having to deal with them twice."

Helped by training as an electrical engineer and an MBA from Stanford, Young rose speedily through Hewlett-Packard. By the time he was 31 he had become general manager of the microwave division, then the company's largest, and at 46 he took the reins from company founders William Hewlett and David Packard. Today he also chairs the Council on Competitiveness, a group dedicated to making U.S. industry a stronger force in the global battle, and he thinks that what's good for Hewlett-Packard is good for America. "We've ignored a critical success factor: speed," he says. "Our competitors abroad have turned new technologies into new products and processes more rapidly. And they've reaped the commercial rewards of the time-to-market race."

Young uses several techniques to get Hewlett-Packard moving faster. At the Lake Stevens, Washington, facilities, which make electronic testing equipment, engineers have an expert system, a computer that uses artificial intelligence. It automatically analyzes each design and recommends changes that would make a new product easier to manufacture—by using more parts that snap rather than screw together, for instance. Over the past three years the operation has cut failure rates for its 30 products by 84% and manufacturing time by 80%.

The company also uses computers to speed communications. If an engineer wants the best and fastest solution to a design problem, he sends out a query on a computer network that links him with colleagues around the world, forming, in effect, one big brain that can direct its power to the task at hand. The network also provides a catalogue of parts the company knows from experience are cheap and reliable.

Young recently assembled 100 productivity managers to watch the company's 90 R&D labs. Like hyperactive honeybees, they constantly cross-pollinate the labs with the wisdom and experience of others. Says corporate engineering director Marvin Patterson: "They are experts trying to solve problems, not middle managers taking up space."

Hewlett-Packard has made considerable progress. It developed the DeskJet printer, the first near-laser-quality printer retailing for under $1,000, in just 22 months. A job like that used to take over twice as long. The DeskJet became an instant hit when introduced last year.

Yet Young thinks his company is still too slow. To remedy that, he last winter announced a sweeping, companywide program called BET, for breakeven time, in which he challenged employees to cut by half the interval between a new product's conception and profitability. It's an awesome challenge, much like trying to make a Volkswagen drive as fast as a Porsche. The only way to do that, of course, is to redesign the car. Young hopes BET will force his managers to redesign the product development process, getting people from all divisions to work together in flexible, fast-moving teams.

Don't such dramatic goals make workers feel strained or afraid? No, says Young: "People find speed exciting. After all, my workers like the challenge. They like to win at business. That's why they're there." The fast chief executive with the cool exterior feels the same way.

"When you're dealing on the edge of the envelope, when you're flying blind, there's always the temptation to take a little more time," says Scott Shamlin, a director of manufacturing at Motorola. "But we hold to schedule as a religion." Motorola's automated factory in Florida can build and ship an electronic pager some two hours after it receives an order. The job used to take three weeks. Motorola leads the U.S. pager market over Asian rivals.

■ **REMEMBER DISTRIBUTION.** Even the world's fastest factory won't offer much competitive advantage if everything it produces gets snagged in the distribution chain, a lesson Benetton, the Italian sportswear company, has knit in its heart. Located in Ponzano, Italy, Benetton makes and distributes 50 million pieces of clothing worldwide each year, mostly sweaters, slacks, and dresses.

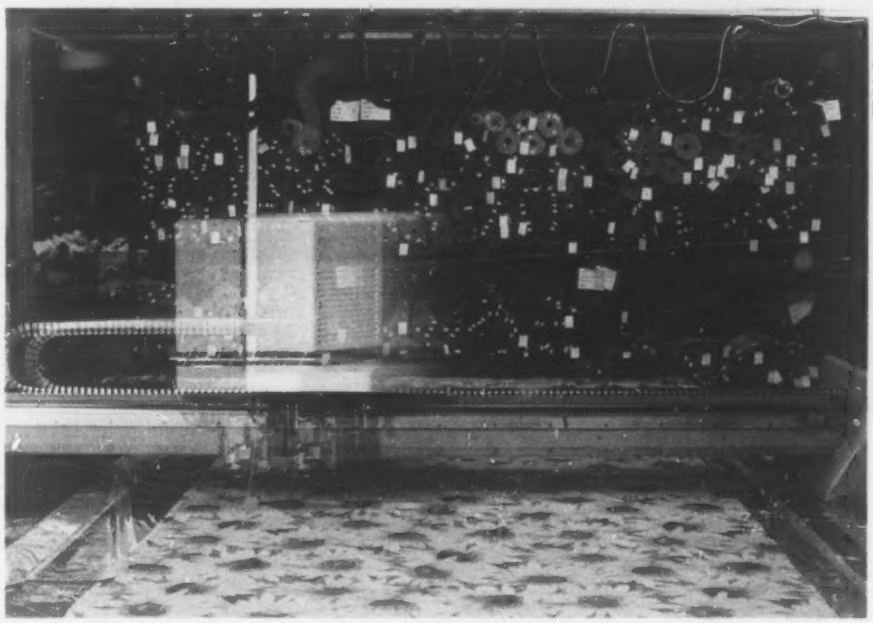
Benetton found that the fastest way to run a distribution system is to create an electronic loop linking sales agent, factory, and warehouse. If, say, a saleswoman in one of Benetton's Los Angeles shops finds that she is starting to run out of a best-selling red sweater in early October, she calls one of Benetton's 80 sales agents, who enters the order in his personal computer, which sends it to a mainframe in Italy. Because the red sweater was originally created on a computer-aided design system, the mainframe has all its measurements on hand in digital code, which can be transmitted to a knitting machine. The machine makes the sweaters, which factory workers put in a box with a bar code label containing the address of the Los Angeles store, and the box goes into the warehouse. That's right—one warehouse serves Benetton's 5,000 stores in 60 countries around the world. It cost $30 million, but this distribution center, run by only eight people, moves 230,000 pieces of clothing a day.

Once the red sweaters are sitting snugly in one of 300,000 slots in the warehouse, a computer sends a robot flying. By reading the bar codes, the robot finds the right box and any other boxes being shipped to the Los Angeles store, picks them up, and loads them onto a truck. Including manufacturing time, Benetton can get the order to Los Angeles in four weeks. If the company already has red sweaters in stock, it takes one week. That's quite a performance in the notoriously slow garment industry, where hardly anyone else will even bother with reorders. And if Benetton suddenly realizes that it didn't make any, say, black cardigans and purple blouses this year and they're hot, it can manufacture and ship a "flash collection" of black cardigans and purple blouses in huge quantities in a few weeks.

■ **PUT SPEED IN THE CULTURE.** Honda did, and it definitely helps. Though the company entered Formula One auto racing only six years ago, cars powered by Honda engines have won this demanding annual circuit three times. By circulating young engineers through the Formula One team, Honda teaches its people the racing spirit, which means thinking about minutes, not hours. Shoichiro Irimajiri, a managing director at Honda, points out important similarities between the race track and the factory: "When a problem arises, you have to find the solution now. And if it is a problem you have never seen before, you have to have the flexibility to create a new solution on the spot."

Putting speed in the culture can be fun. Just look at Domino's Pizza, which has become America's second-largest pizza chain (after Pizza Hut) by promising customers a $3 discount on any pie that takes longer than 30 minutes to arrive at their home.

CEO Tom Monaghan, who reads the sports pages religiously, owns the Detroit Tigers, and jogs 6½ miles a day, has modeled his company on a professional sports league, with regional divisions competing to make the best pizza, deliver it faster, and sell more than the next region. Like quarterbacks on Monday mornings, Domino's pizza makers watch films of the fastest pizza makers in the country. A delivery person, whose uniform includes track shoes, must run from the truck to the house, taking stairs two at a time—elevators are forbidden because they take longer—carrying the pizza in his arms like a tailback headed for the goal line. Domino's franchisee in Washington, D.C., takes managers out every Monday for a six-mile jog. Says Monaghan: "Our whole business is built on speed."



VITTORIANO RASTELLI

A Benetton computer directs this machine to start cutting cloth soon after orders arrive.

The advantages of speed are undeniably impressive. But why should that be surprising? Why all the hoopla among management theorists? After all, it's not exactly a new precept that time is money.

True enough. What's new is a realization that time is an awful lot of money—far more than most executives understood. Warns Istvan of Boston Consulting Group: "If you come up against one of these fast corporations and you're not prepared, you're history." Those who grasp the new calculus, who appreciate the unprecedented advantages of getting new products to market sooner and orders to customers faster, may well hold the principal tool for achieving competitive preeminence in coming years. F

WHAT FOREIGNERS WILL BUY NEXT

Auto parts makers, semiconductor producers, and biotech outfits with lots of strong patents will be the hottest tickets. Look for some very fancy prices.

■ *by John J. Curran*

THE FOREIGN ACCENT in the U.S. takeover game is bound to get heavier in the next few years. Increasingly aggressive and sophisticated international companies are spending freely—some would say wildly—for big pieces of American industry. So far, returns have been meager, but foreign buyers have more on their agenda than short-term profits. As their influence grows, they could bring some lasting changes to the American mergers and acquisitions market.

Foreign buyers represent a new kind of acquisitor. Unlike leveraged-buyout artists, they are less interested in big, cash-rich companies loaded with plodding divisions that can be sold to pay off debt. Says Ryuuji Kitamura, senior vice president of C. Itoh, a Japanese trading company that has made numerous U.S. acquisitions: "We don't sell our babies to pay the bills. Breaking up companies is not our way."

Instead they try to advance strategic goals. The companies they seek are likely to be smaller, lesser-known firms whose acquisition can round out a global market position, add a U.S. plant, or provide access to new technology or a strong brand name. When foreign buyers find a company that fits, they go for it regardless of price. Many have paid what American counterparts would regard as too much.

As their influence on Wall Street grows, foreigners may change the way American investors value companies. The emphasis could shift from cash flow and breakup value—the popular determinants of worth now—toward more strategic considerations. The definition of a hot takeover stock could change too, with small biotech and semiconductor companies held in higher esteem than giant breakup candidates.

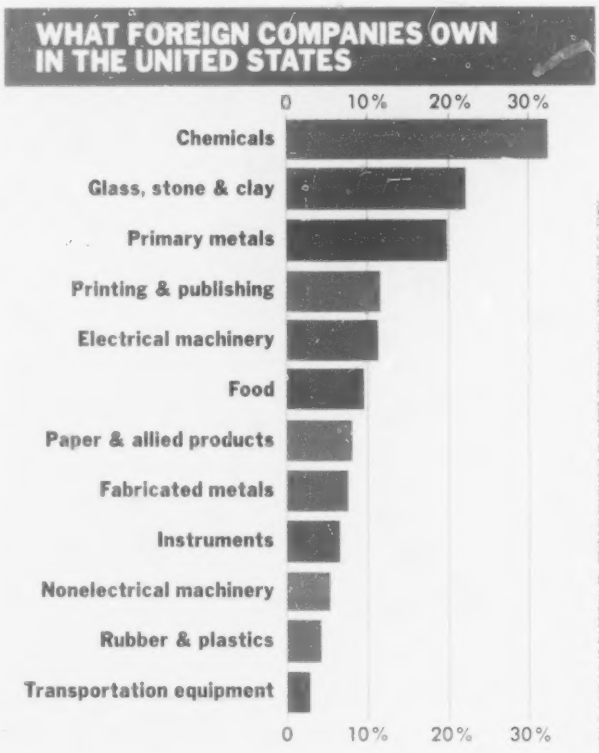
If foreigners keep paying inflated prices, though, they could drive up stakes for all acquirers and reduce returns. That's good news for shareholders, who can expect ever higher bids for their stock; bad news for CEOs hoping to expand through acquisition. American companies could increasingly find themselves priced out of the market.

Foreign takeovers are still small in comparison with the billions spent by U.S. companies to gobble each other. In 1988 foreigners accounted for less than 20% of all U.S. deals. But that is sure to rise as the Japanese continue their shopping spree. Japanese exporters are eager to shift production to the U.S. to counter protectionist sentiments and because the strong yen makes America a lower-cost place to manufacture. U.S. acquisitions by Japan are already way up. In 1987, the latest year for which hard numbers are available, there were 146 deals, more than double the year before. Last year, according to estimates, the number was nearly 200.

The foreign share could grow even more if Congress decides to curtail domestic takeovers. One popular proposal to curb LBOs would reduce the deductibility of interest on takeover debt (see Politics & Policy). That could make many deals uneconomic for American buyers, but would leave the field wide open to foreign bidders, since most could continue deducting interest charges in their own countries.

It's hard to prove that foreigners pay too much, since they often acquire private companies. But investment bankers who work on their deals say the prices are often excessive. Says Peter Rona, president of IBJ Schroder Bank & Trust, a New York–based subsidiary of Industrial Bank of Japan, which has participated in dozens of international deals: "In the 1980s foreigners have significantly overpaid for acquisitions."

The surest indication of foreigners' largess is in the shockingly poor returns they have earned on their U.S. investments in recent years. During 1987, not an atypical year, the return on direct foreign investments in U.S. assets amounted to no more than 5% on average, according to statistics



SOURCE: U.S. DEPARTMENT OF COMMERCE, BUREAU OF ECONOMIC ANALYSIS. ALL FIGURES AS OF JANUARY 1, 1987

REPORTER ASSOCIATE *Susan E. Kuhn*

compiled by the Commerce Department. That's well below what American investment bankers would consider a competitive return. Of the six groups Commerce studied, the Japanese did worst, earning less than 4%, while the British did best, earning 6.7%. The Continental Europeans averaged a return of 5.4%.

DESPITE SUCH abysmal results, foreign companies will forge ahead and even pick up the pace of acquisitions. Siemens, the West German electronics giant, has made over 30 acquisitions in the U.S. but has yet to turn a profit. Says Hans Decker, president of the U.S. subsidiary: "Sure my company is not happy that we aren't making money from our U.S. holdings. But we are taking the long-haul view—we must." Siemens has stated that it will continue to be an aggressive acquirer of American assets in the years ahead.

Such a profits-be-damned approach could lead American companies to overbid in making acquisitions of their own. General Electric bought Borg-Warner's chemical business last September for $2.3 billion, an amount rumored to be beyond what Borg-Warner thought it could get. The reason for GE's generosity, investment bankers say, was that it was bidding against an aggressive group of companies, including a number of foreign firms. "GE wanted to make sure that foreign interests did not get into this particular segment of the market," says one banker. Borg-Warner's chemical division is the world's leading producer of ABS resins, used to make plastics for home appliances and automotive components, and a good fit with GE's fast-growing plastics business.

Many industries that foreigners have their eyes on are also the most promising for American companies. Siemens has identified five high-growth areas where it will continue to acquire: factory automation, office automation, telecommunications, semiconductor technology, and diagnostic medical equipment. In December, Siemens peeled off $844 million of its war chest of $10 billion in cash and marketable securities to buy the manufacturing arm of ROLM, a maker of computerized private telephone systems, from IBM.

One reason foreigners make such generous bids for U.S. companies is that they assess the value of a takeover target differently than Americans do. In the U.S., managers determine the price of a potential acquisition either by discounting projected cash flow to arrive at a present value or by looking at the cash flow multiples that similar companies in the same industry have sold for. While these methods can result in pricey deals too, especially when egos get involved, they generally are grounded in reality, since the cash flow from the acquired business must be sufficient to service the debt used to make the acquisition.

Foreign buyers, especially the Japanese, tend to skip such calculations. They want to know what the target company can do for them in the long run, how it augments the marketing plans they have already made. Says Peter G. Peterson, a former Secretary of Commerce and now chairman of the Blackstone Group, an investment bank that has handled some of the biggest Japanese deals: "Once they decide to buy a particular company, they are less likely to be deterred by price." Sometimes, he adds, "we have to tell our clients: 'Look, you're paying more for this company than an American company would pay.' "

When foreign competitors duel each other for a U.S. company, the bidding can quickly reach astronomical proportions. Says Claus Moehlmann, a managing director of First Boston who specializes in international acquisitions: "What you have are the best players worldwide looking to round out their global positions. They all go after the same properties."

Bridgestone's 1988 acquisition of Firestone is a prime example. The Japanese tiremaker entered the bidding after Pirelli of Italy made an initial hostile tender of $58 a share. The stock had been selling for around $35. Fearing that a large part of the huge American tire market would fall into Italian hands, Bridgestone countered with $80 a share, 38% higher than what Pirelli had bid. Not surprisingly, Bridgestone won. The reaction among analysts and investment bankers familiar with the deal was

SEIKO TAKADA

SCOTT WITTE

Dainippon President Shigekuni Kawamura controls this Reichhold Chemicals plant in Illinois.

unanimous. Says one: "There's no question that Bridgestone paid too much."

Premium pricing is not limited to the Japanese. Campeau Corp. of Toronto bought Allied Stores for 25 times earnings in 1986, when the average multiple for such deals was 16. Last December, British publisher Robert Maxwell paid $90 a share for Macmillan, which was 40 times earnings and 539% of book value. Grand Metropolitan, the British food and liquor company, took over Pillsbury at the beginning of this year with a bid of $66 a share. Says James Murren, an analyst at C.J. Lawrence Morgan Grenfell, the New York subsidiary of a London securities firm: "You won't find anybody outside of a few Pillsbury employees who think that company is worth even $60 a share."

Part of the reason foreign companies can afford to pay so much is that they live by different accounting rules. Take the matter of goodwill, defined as that part of the purchase price that exceeds the market value of the assets acquired. If an American firm acquires another company, goodwill must be written off against income over a maximum of 40 years, producing a drag on earnings per share.

IN BRITAIN companies are able to write off goodwill against shareholders' equity, where it does no damage to earnings per share. Further, the acquiring company can prevent any potential damage to shareholders' equity by doing a "rights offering" prior to the buyout. The rights offering is an offer to sell additional stock to existing shareholders, usually at a discount, if the acquisition goes through. By this approach, the loss to shareholders' equity from the goodwill charge is mended by an additional input of new equity. Last October, Grand Met issued an $830 million rights offering in anticipation of its bid for Pillsbury.

If an American company had acquired Pillsbury at the price Grand Met paid, it would face an annual charge against earnings of around $50 million for goodwill for each of the next 40 years. Or consider another foreign buy: Unilever's 1987 acquisition of Chesebrough-Pond's. If an American firm had paid Unilever's price of $3.1 billion for this big consumer products company, the annual charge against earnings for goodwill would have been as much as $60 million a year for 40 years. Such

MAJOR FOREIGN ACQUISITIONS OF THE 1980s

YEAR	U.S. COMPANY BRANDS OR PRINCIPAL BUSINESS	FOREIGN OWNER COUNTRY	PRICE PAID MILLIONS
1989	**Triangle Industries** packaging	**Pechiney** France	$1,251
	Pillsbury Burger King, Green Giant, Häagen-Dazs	**Grand Metropolitan** Britain	$5,717
1988	**Farmers Group** insurance	**BAT Industries** Britain	$5,148
	Macmillan publishing	**Maxwell Communication** Britain	$2,558
	Triangle Publications *TV Guide, Seventeen*	**News Corp.** Australia	$3,000
	Gould electronics	**Nippon Mining** Japan	$1,061
	Intermedics pacemakers, medical products, electronics	**Sulzer Brothers** Switzerland	$800
	Federated Dept. Stores Abraham & Straus, Bloomingdale's	**Campeau** Canada	$6,520
	Telex computer terminals	**Memorex International** Netherlands	$920
	Staley Continental corn products, food service	**Tate & Lyle** Britain	$1,572
	Firestone Tire & Rubber tires	**Bridgestone** Japan	$2,621
	Tropicana Products fruit juices	**Seagram** Canada	$1,200
	G. Heileman Brewing Old Style, Colt 45	**Bond Corp. Holdings** Australia	$1,275
	First Jersey National banking	**National Westminster Bank** Britain	$820
	CBS Records Columbia, Epic	**Sony** Japan	$2,000
1987	**Kidde** Jacuzzi, Farberware, PGA golf clubs	**Hanson** Britain	$1,708
	Manpower employment services	**Blue Arrow** Britain	$1,342
	Reichhold chemicals	**Dainippon Ink & Chemicals** Japan	$550
	Heublein Smirnoff, Inglenook	**Grand Metropolitan** Britain	$1,200
	Celanese chemicals	**Hoechst** W. Germany	$2,886
	Chesebrough-Pond's Prince Matchabelli, Ragú, Vaseline	**Unilever** Britain/Netherlands	$3,096
1986	**Allied Stores** Ann Taylor, Jordan Marsh	**Campeau** Canada	$3,506
	Big Three Industries industrial gases	**L'Air Liquide** France	$1,044
	SCM Corp. Smith-Corona typewriters	**Hanson** Britain	$926
1985	**Inmont** inks	**BASF** W. Germany	$1,000
	Carnation Coffee-mate, Contadina, Friskies pet foods	**Nestlé** Switzerland	$2,941
1984	**Sedco** oil drilling	**Schlumberger** Netherlands Antilles	$970
	Utah International natural resources	**Broken Hill Proprietary** Australia	$2,400
1981	**Santa Fe International** oil and gas drilling	**Kuwait Petroleum** Kuwait	$2,501
	Texasgulf natural resources	**Elf Aquitaine** France	$2,742

SOURCE: MORGAN STANLEY & CO.

charges would be sure to evoke the wrath of security analysts and shareholders.

Some countries on the Continent don't recognize goodwill at all. Others permit several ways of disposing of it quietly, including shunting it to the shareholders' equity account as the British do. Even if a charge for goodwill does make it to the profit and loss statement, as is possible under West German accounting rules, it does not cause much of a stir since investors have a relaxed attitude toward financial reports. Says one European investment banker: "Shareholders here live in a sleepier world." Lack of investor scrutiny, bankers say, gives European companies tremendous leeway to bid aggressively.

The rules give an accounting edge to the Japanese too. Typically their acquisitions are carried on the balance sheet at cost, so goodwill is not recognized. If an acquisition should crimp earnings per share for any other reason, it would hardly matter. Says C. Itoh's Kitamura: "You won't even find earnings per share in most Japanese shareholder reports. Investors just don't care about it."

In short, what can be a huge problem for American companies is no problem for foreign bidders. Says Jeffrey Rosen, co-head of international mergers and acquisitions at Wasserstein Perella, a New York investment firm: "There's no question that accounting gives foreign acquirers a big advantage over American companies. It also helps justify some deals that couldn't be justified on an earnings-per-share basis."

Many foreign acquirers also enjoy a significantly lower cost of capital, which allows them to accept a smaller return on overseas investment. Because Japanese interest rates are around 5%, companies can afford a higher offering price than American bidders tied to the prime rate, currently 10.5%. Japanese companies can also issue convertible bonds, which yield only 1.5%, further reducing their cost of capital.

NO INDUSTRY has been of greater interest to foreigners in recent years than chemicals. Foreign companies now own 32% of the industry's assets. The international slugfest began in 1985. Imperial Chemical of Britain paid what was then a fat 19 times earnings for the chemical division of Beatrice Foods. Later in the year BASF bought United Technology's Inmont chemical division, a leading producer of ink, for an equally rich price/earnings multiple. Most recently

FOREIGN EARNINGS ON U.S. INVESTMENTS

SOURCE: BUREAU OF ECONOMIC ANALYSIS, U.S. DEPARTMENT OF COMMERCE

The price of overpaying: When foreign companies went on a buying binge in the 1980s, their returns began to slip.

Reichhold Chemicals was acquired by Dainippon Ink & Chemicals of Japan in a pricey—and hostile—takeover.

The auto industry is about to become a hotbed of takeovers. No, nobody is going after General Motors. But investment bankers at Nomura and other Japanese firms are scouring the U.S. for parts suppliers. Cars account for 36% of the U.S. trade deficit with Japan. Peterson of the Blackstone Group believes the Japanese really want to whittle down their surplus, and to do that they will push for U.S. automotive acquisitions. Says he: "In order for the manufacturing component of the trade deficit to turn, there is going to have to be a major turn in the automotive sector. That means foreigners will have to produce more cars and more parts in the U.S." For the Japanese, of course, increasing U.S. production is also good business. The strong yen makes it more profitable to build cars in America than import them. And as the Japanese increase production they will want to own more of their suppliers.

The weakening semiconductor industry also ranks high on the shopping list of foreign buyers. In addition to Siemens, other globally minded technology companies are eager to acquire a worldwide presence in chip manufacturing. Here, too, many of the suitors will be Japanese. Their timing is good. After some boom years, the industry is entering a flat period. The big premium in price/earnings multiples that semiconductor stocks once had has vanished.

Smaller industries, like paints and adhesives and test and measuring devices, are fertile ground for foreign incursions as well, investment bankers say. But none will attract as much attention as biotechnology. The Japanese in particular are hungry for biotech breakthroughs—and the patents that go with them. Analysts expect that many struggling, cash-short American bio-

DAVID GAMBLE

Allen Sheppard of Britain's Grand Met won flourmaker Pillsbury with a $66-a-share bid.

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JOYCE RAVID

Peterson: midwife to big Japanese deals

tech firms will command some of the richest takeover premiums in the years ahead.

Foreign buyers will continue to avoid giant diversified companies. While a few, such as Britain's Hanson PLC, occasionally go for such targets, most foreign buyers, especially the Japanese, have a strong preference for pure plays where they can buy the business and keep all the parts. Nor will Japanese buyers become big players in the hostile bidding war. Though they will sometimes consider roughhouse tactics to land their prey, most are still far from following Dainippon Ink & Chemicals' successful raid on Reichhold Chemicals. Says Blackstone's Peterson: "It's just not their way to do unfriendly deals."

CORPORATE AMERICA'S debt binge could produce another group of tantalizing takeover candidates, those infamous so-called stub stocks. Foreign firms are keeping close tabs on these companies, which have undergone leveraged recapitalizations that resulted in large payouts to shareholders, huge debt, and just a "stub" of public ownership left. Many of these companies will be sorely in need of an equity injection when the next recession hits. Says Moehlmann of First Boston: "Foreign firms are hoping to pick up those companies at a very good price."

Such unabashed acquisitiveness by foreigners may grind against the nerve of American nationalism. But as long as Americans continue to overconsume, there will be a need for foreign capital. To the extent that such a need exists, it is far better to get those infusions in the form of risk-sharing equity capital rather than still more debt. What's more, foreign capital is helping to rebuild America's industrial base. Many foreign acquirers are following up their acquisitions with additional capital to refurbish outdated plants and equipment. Bridgestone, for example, will invest $1.5 billion to modernize and expand Firestone's facilities.

The foreign takeover frenzy may bring a less tangible but no less important benefit. The willingness of foreign managers to accept substandard returns from their American investments in favor of longer-term strategic considerations is a risk that may or may not pay off. But to the extent that such a long view prompts American managers to be even a little less obsessed with short-term performance and a little more concerned with their company's long-range competitive position, it may turn out to be an unexpected dash of good fortune for American industry. F

JIM TEITCH

Siemens of West Germany is the new owner of this ROLM plant in California.

GREAT JAPANESE MISTAKES

Sure, the economic colossus of the East seems to be whipping the rest of the world with regularity. But take heart: Nobody's perfect. ■ *by Carla Rapoport*

A BRIDGE TOO FAR
This $9 billion engineering wonder goes to an island few Japanese care to visit. The government plans two more bridges.

IN CASE YOU MISSED IT, the Japanese economy grew at a 9.3% rate in the second quarter of this fiscal year. Inflation? Almost nothing. Crime rate? Still among the lowest in the industrialized world. Not only is Japan rich, but everything still works. Well . . . almost everything.

In the dazzling glare of Japan's economic successes, it's easy to forget that the Japanese make mistakes like the rest of us. So, for just a moment, stop worrying about the Japanese challenge, put away the latest best-seller on Japan's plans to conquer the world, forget about the Pacific Rim for the rest of the day. Kick back, put your feet up, and enjoy a tour of Japanese bloopers.

They come in all shapes and sizes—from one-day business wonders like singing underpants to pork barrel extravaganzas that would have made Mayor Daley blush. "We are not Superman," says Hiroshi Mitsukawa, an official at the powerful ministry of international trade and industry (MITI). He should know. His department served as undertaker to Japan's boom-to-bust aluminum smelting industry, but not before it lost an estimated $2.5 billion. Adds Tadashi Yamamoto, head of the Japan Center for International Exchange, a foreign policy think tank: "People still think there is some kind of machine here, spewing out answers to every question. There isn't. The magnitude of some of Japan's failures is really incredible."

First, stop at Narita airport. Japan is a country where the trains run on time, the streets are clean, and the police spend most of their time giving directions to lost motorists. Yet Narita, Tokyo's main international airport, has only one runway. (New York's JFK has five.) Eleven years after opening, the airport remains unfinished. Some 45 airlines from 39 countries have yet to gain landing rights. If you do manage to land, you'll feel as if you're breaking out of prison when you head for town. The airport is surrounded by barbed-wire fences and guard towers manned by more than 1,500 policemen, most armed and in riot gear. What's going on here?

REPORTER ASSOCIATE *David Kirkpatrick*

MIGHTY MITI's RESEARCH DUDS

PROJECT: Remote-controlled undersea oil-drilling rig 1970-75
COST $36 million
REASON FOR FAILURE: The device turned out to be no cheaper or easier to operate than conventional offshore oil rigs.

PROJECT: Electric car 1970-77
COST $46 million
REASON FOR FAILURE: Like everyone else, the Japanese have been unable to make a battery that lasts long enough for driving.

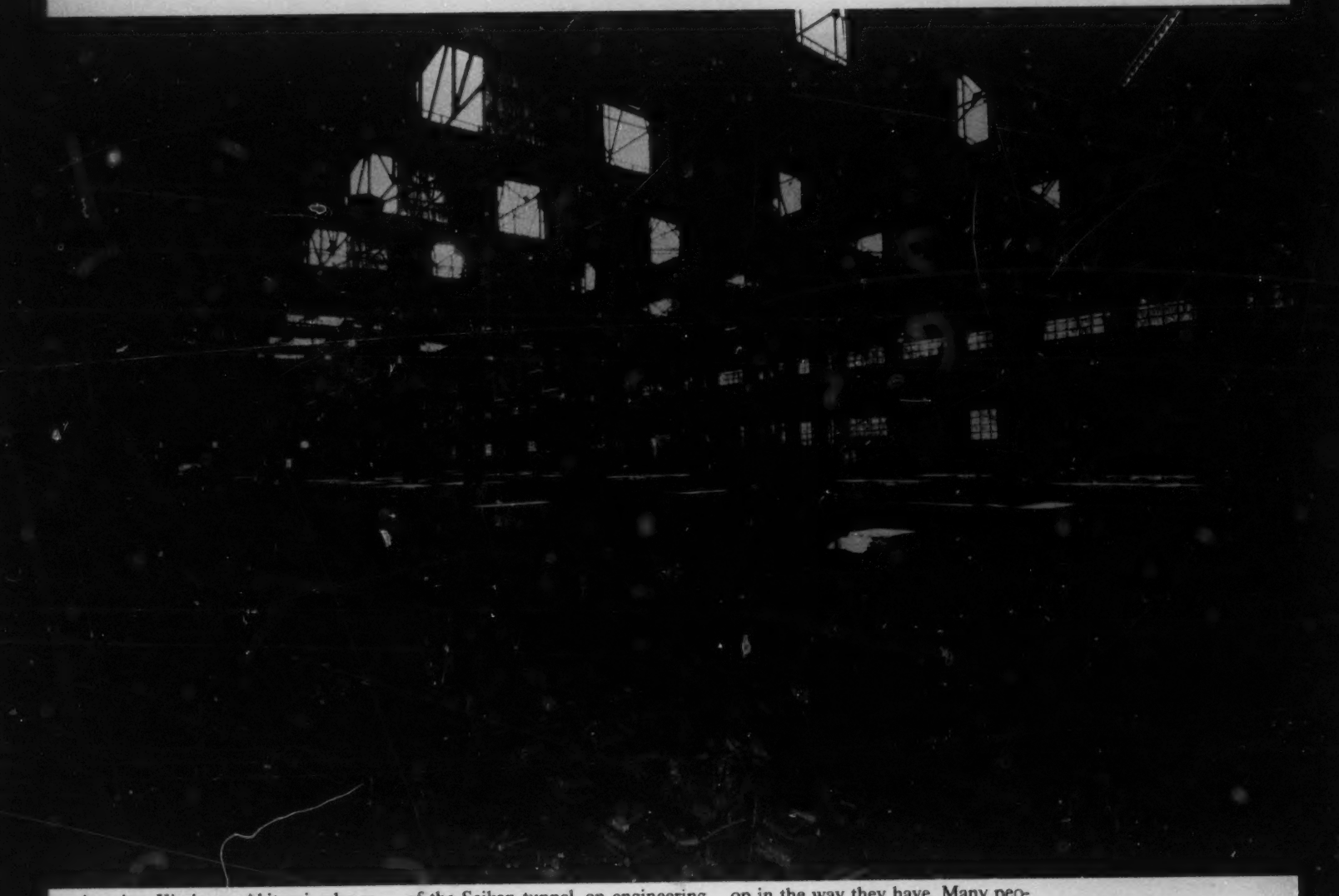
PROJECT: Nuclear-powered blast furnace for steelmaking 1973-80
COST $110 million
REASON FOR FAILURE: MITI underestimated the antinuclear lobby, which managed to kill the project before completion.

PROJECT: Petrochemicals from carbon monoxide 1980-86
COST $84 million
REASON FOR FAILURE: The worldwide oil glut made such costly alternative production unnecessary.

PROJECT: Integrated circuits to withstand cold weather 1981-85
COST $11 million
REASON FOR FAILURE: MITI realized nobody was interested in buying such circuits and dropped the project.

THE ANSWER lies in a grimy two-story shack surrounded by barbed wire and fences just beyond the airport. This is the headquarters of the Chukaku-ha, a group of radicals who have managed to outsmart Japan's bureaucracy. Says Koichi Kishi, the well-dressed leader: "Narita is the last battleground. As long as Narita exists, we'll be here to fight it." So far, his followers have limited themselves to nuisance bombings and physical attacks. But they intend to go further. Says Kishi calmly: "It's our goal to destroy this airport. Our technology is not up to that standard yet, but it will be. We'll fight to the end."

This perhaps lunatic but effective fringe came to the area in the late 1960s to support vegetable farmers being pushed off their land to make way for the airport. Today eight of the original farmers plus scores of supporters live on what was supposed to be Narita's second runway, with the Chukaku-ha standing guard nearby. Airport officials say they hope to clear out protesters and finish the airport by the spring of 1991. That's hard to



imagine. Kimimasa Akitomi, who recently resigned as president of the airport authority, concedes that the real mistake at Narita was made years ago when farmers were not fully consulted on the government's plans.

The Japanese have a word for such consultation—*nemawashi*, literally the careful wrapping of a plant's roots before it is transplanted. Without *nemawashi*, things can go very wrong in Japan. Says a government official who asked not to be named: "In Narita's case, I fear the roots are dead. I don't know if we'll ever be able to get things right there."

The roots may be dead at Narita, but at least the airport is being used. In the town of Aomori, festivities earlier this year marked the opening of the Seikan tunnel, an engineering feat that took 24 years and set the government back $8.4 billion. The 86-mile tunnel, part of a grand prewar scheme to link Japan's four major islands, gets travelers from Tokyo to Sapporo in 12 hours and ten minutes, compared with 14 hours before. Of course, if travelers were in a hurry, they would fly, which takes an hour and 25 minutes. Not surprisingly, almost everyone going there takes the plane.

The Seikan tunnel was a dream for postwar Japan. Explains Ryohei Kakumoto, a director of the Japan Transport Economics Research Center, a privately funded research organization: "We could hardly imagine that airplanes would develop in the way they have. Many people died in ferry accidents in the 1950s. We thought the tunnel would be safer." A critic of Japan's transportation network, Kakumoto argues that even though the tunnel is finished, Japan should shut it down to eliminate further costs of maintenance and operation.

HARSH MEDICINE like that could also be prescribed for a $9 billion bridge completed last April between Japan's main island of Honshu and the semitropical, sparsely populated island of Shikoku. The bridge, the first of three aimed at bringing prosperity to backward Shikoku, is an engineering marvel but a commercial disaster.

continued

AN INDUSTRY TOO COSTLY

Planners didn't reckon on rising electricity prices when they built Japan's aluminum smelters, such as this now-empty one near Mount Fuji. The industry is all but dead.

PHOTOGRAPH BY ROBIN MOYER

Of the 25,000 cars and trucks forecast to cross the toll bridge daily, only 13,000 are making the trip. (Heavy trucks pay $135, twice the ferry fare.)

Though most of the officials who made the original decision are gone, construction on the other two bridges continues. Why three bridges? Welcome to Japanese pork. Grouses a senior government official: "We've got three bridges in Godforsaken Shikoku and none across Tokyo Bay. These bridges are a scandal. One bridge, OK, maybe two. Three? Ridiculous."

SO THE JAPANESE are as good as the rest of us when it comes to waste and excess. What about commercial misfires? The best way to see Japan's biggest industrial boo-boo is from the air. Some 50 miles from the mouth of of the Tigris River, at a spot known as Bandar Khomeini on Iran's Persian Gulf shore, is a one-square-mile site of rusting girders and beams. Since it's easy to see, Iraqi planes were able to hit it with bombs on 19 raids. This mess is what's left of a $4.8 billion petrochemical project, a joint venture between the Iranian government and a group of Japanese companies led by Mitsui & Co.

The project was started in the early 1970s. Mitsui doggedly stuck to it through the Iranian revolution and in the face of overcapacity in the world petrochemical industry. When the Iran-Iraq war broke out, the Iranians insisted they could protect the plant. The complex was 85% finished when the first bomb fell in September 1980.

Of the $4.8 billion already lost, half came from Japanese sources, with 60% of that from Mitsui. Most of Mitsui's exposure, according to the company, is guaranteed by the Japanese government; the rest is covered by a special provision on the balance sheet. As part of the deal, Mitsui had been granted oil exploration rights in Iran. How did they work out? Says a Mitsui official with a shrug: "We didn't find a thing."

Mitsui can't take all the blame for Bandar Khomeini. The project was backed by MITI and Japan's Export-Import Bank. MITI is often credited with orchestrating Japan's industrial successes. Official chroniclers, however, often leave out MITI's orchestrated mistakes. Top of the list has to be Japan's aluminum smelting industry.

James Abegglen, an American who heads Asia Advisory Service, a management consulting firm in Tokyo, and is author of *Kaisha*, a book about the Japanese corporation, calls aluminum smelting in Japan "one of the biggest strategic mistakes in history." Officials at MITI don't disagree. Says Mitsukawa: "When electricity was cheap and raw materials were easily imported, we thought it would be a good industry for us." He explains that his predecessors did not expect electricity prices to go up so high after the oil shock.

At its peak in 1977, Japanese aluminum smelters had capacity to produce 1.64 million tons per year and employed more than 11,000 people in 14 companies. Today only one smelter is left, with 140 workers. Despite tax breaks and subsidies, accumulated losses for the industry peaked in 1985 at $1.1 billion. That was a heavy hit for the five companies still in the business. Says Abegglen: "One of the paranoid fantasies Westerners have about Japan is that the Japanese can see the future. They can't."

IF YOU HAVE any doubts, turn back to the table of MITI's research and development miscues of the past decade or so. Here are the projects you don't read about, the ones quietly buried away from the public eye. A nuclear-powered blast furnace and an undersea remote-controlled oil-drilling rig are two of a host of post–oil shock projects that have yielded no commercial results. More recently, MITI suffered another black eye when All Nippon Airways chose a General Electric engine for its new jets rather than the V-2500 jet engine developed in Japan by a group of engineering companies with around $200 million of MITI subsidies.

Even without MITI's help, Japanese managers make mistakes. A few are well known, like Sony's failure to capitalize on its Betamax format in videocassette recorders, eventually losing out to VHS. Most, however, are not, mainly because few Japanese companies make big, bet-the-company kinds of decisions. Further, explains Tom Zengage, a director of IBI, a consulting firm in Tokyo, Japanese annual reports are not that detailed. Says he: "When companies get into trouble, they can smear one division's losses into another. Things don't show up. After a loss-making subsidiary is spun off,

A LACK OF CONSENSUS
Aided by radicals, these farmers are blocking a badly needed second runway at Narita, Tokyo's main international airport.

MANEE CENETA

there will be 85 tons of earth on it."

The dogged pursuer of the bungled, however, can find rich pickings among Japan's American exploits. Consider the assault on the U.S. elevator market by Osaka-based Fujitec. President Shotaro Uchiyama told the New York *Times* in 1982 that he planned to move the company's headquarters to New York City, buy himself a $1 million apartment, build a multimillion-dollar plant in Ohio, and boost Fujitec's worldwide sales to $500 million a year by 1985. In 1986 the company reported a loss of $43 million, thanks largely to its U.S. efforts, its first loss in 30 years.

Industry experts in the U.S. say Fujitec made a long list of mistakes. The company went after big projects all over the country instead of concentrating on one geographical area. Critics say it underbid to get business, though the company denies it. It pushed ahead with a new U.S. factory before getting a feel for the market, and neglected to build a strong maintenance arm. Says Daryl Anderson, president of Hesselberg Keesee & Associates, an elevator consulting firm in San Francisco: "They didn't ease into the country. They saw a humongous market and became like a kid in a candy store."

Fujitec, still firmly based in Osaka, is profitable again, but the company refuses to comment on the financial status of its U.S. operation. The Ohio plant was finally completed, two years behind schedule. A leading U.S. competitor claims that Fujitec has less than 2% of the American elevator market. He adds, "The company is not a factor in any market at the moment."

SOME 500 MILES southwest of Fujitec's Ohio plant is the Sanyo Manufacturing Corp. in Forrest City, Arkansas. In 1977 Sanyo, a major Japanese electronics company, bought a TV-set assembly plant from Warwick Electronics, then being spun off by Whirlpool. Employment rose from 400 to more than 2,400. But by 1985 Japanese managers found themselves battling the plant's union over fringe benefits and seniority issues.

Eventually Sanyo moved about half the plant's assembly work to Mexico to cut its losses. It didn't work out. A company financial manager in Arkansas reports that the subsidiary lost more than $34 million in 1988. For the three previous years, losses totaled about $42 million. Michael Kane, director of the U.S.-Japan International Management Institute at the University of Kentucky, says, "Japanese companies come with a mind-set. It worked in Japan so it will work in the U.S."

Sumitomo Bank's $500 million investment in Goldman Sachs in return for 12.5% of the firm's profits was quickly made into a mistake by the U.S. Federal Reserve. As final details of the deal were being worked out in November 1986, the Fed ruled that as a commercial bank Sumitomo could have only a passive investment in Goldman, so there could be no significant new business between the firms. Sumitomo thus could send no trainees from Tokyo to Goldman Sachs in New York, as it had hoped. Goldman Sachs officials point out that because of Sumitomo's investment—and the Fed ruling—Sumitomo has less freedom to work with Goldman than do other Japanese banks. Sumitomo declines to comment on the matter. Privately, however, Sumitomo executives admit that they had not realized the ways in which Fed action could harm their deal until it was too late to pull out.

Add another name to the list of companies that saw a major acquisition turn sour in a hurry. Ohbayashi Corp., a leading Japanese construction company, delighted Pearson PLC of Britain last year with an offer of $255 million for Bracken House, the undistinguished headquarters of the *Financial Times* in London. The offer was around $90 million above that of the next highest bidder. The Japanese intended to tear down the building and put up a new one on the site, one of London's best locations. Within days, however, the British government classified the building as historic, preventing any alteration of its 1959 facade. The Japanese are stuck with an overpriced building.

"They weren't getting good advice," says a specialist in property acquisitions in Tokyo. "It's a case of more money than sense." By that measure, it is just possible that more Japanese mistakes are in the making. F

LAURIE SPARHAM—NETWORK

INNOCENTS ABROAD

A Japanese builder paid $90 million more than the next bidder just to get the land under this London building, which now happens to be a protected landmark.

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